

REPORT OF EXAMINATION
OF THE
HOME WARRANTY OF AMERICA, INC.

AS OF
DECEMBER 31, 2006

Filed September 6, 2007

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Los Angeles, California
June 30, 2007

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HOME WARRANTY OF AMERICA, INC.

(hereinafter also referred to as the Company) at the domiciliary address and principal office located at 2030 Main Street, Suite 1200, Irvine, California 92614. The Company's administrative office and primary location of books and records are located at 1371 Abbott Court, Suite A, Buffalo Grove, Illinois 60089.

SCOPE OF EXAMINATION

This examination covers the period from June 16, 2005, the date of the Company's qualifying examination, through December 31, 2006. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; and sales and advertising.

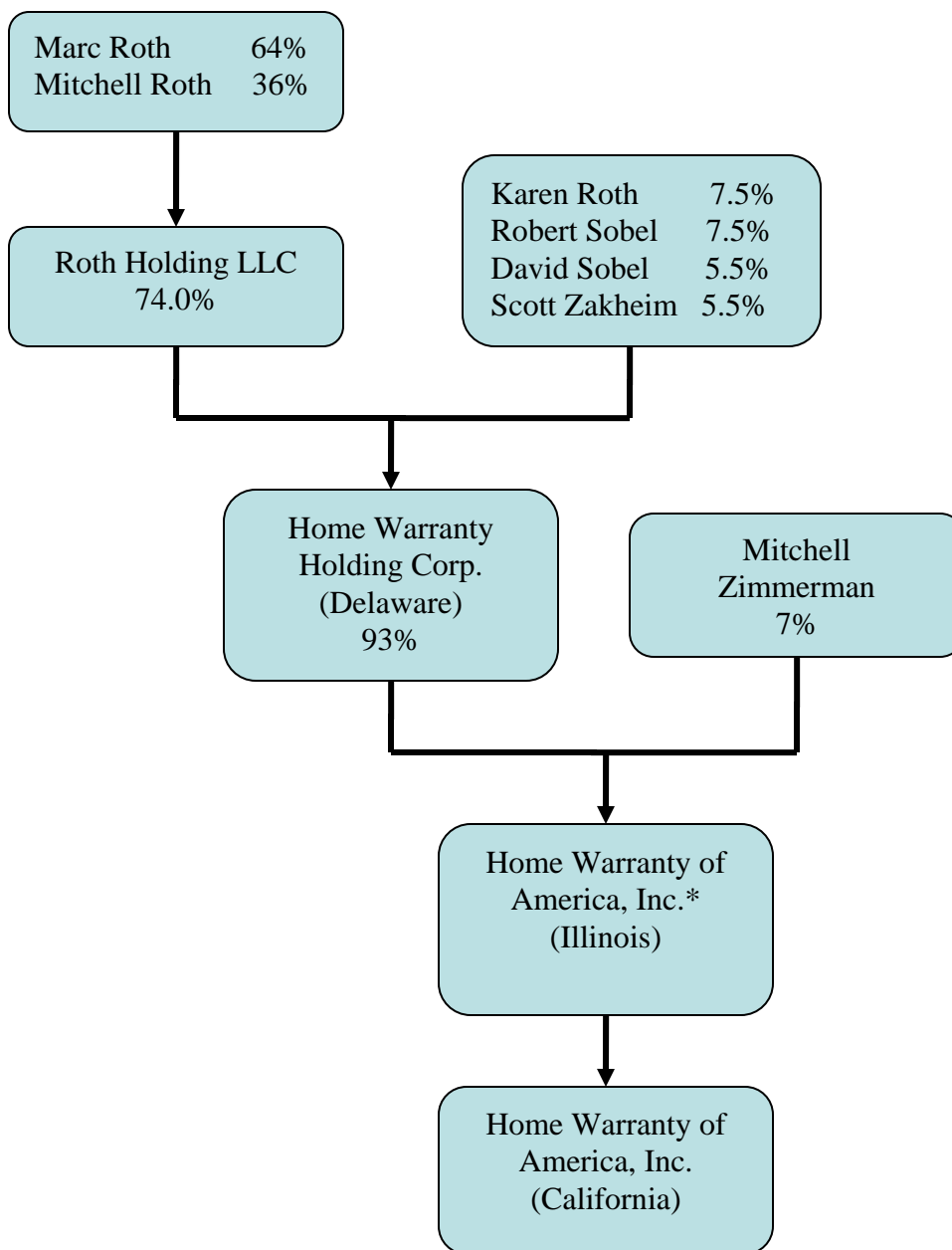
COMPANY HISTORY

The Company was incorporated in the State of California on November 6, 2000. On July 15, 2004, and as subsequently amended on May 3, 2005, the Company filed with the Insurance Commissioner of the State of California its application for a permit authorizing it to sell and issue eight thousand (8,000) shares of its ten dollar (\$10) par value capital stock to Home Warranty of America, L.L.C. at a purchase price of one hundred dollars (\$100) per share for an aggregate cash consideration of eight hundred thousand dollars (\$800,000). The purpose of the sale and issuance was to capitalize the Company so as to qualify it to apply for, and to receive, a home protection company license authorizing it to transact a home protection business in the State of California.

Effective December 30, 2004, the Company's parent changed its name from Home Warranty of America, L.L.C. to Home Warranty of America, Inc., an Illinois corporation. The name change was made part of the Company's First Amendment to Organization Permit SF-2079, effective June 2, 2005. The name change was due to a merger that did not affect the consolidated financial position, ownership or control of the parent company.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Home Warranty of America, Inc., an Illinois corporation. The ultimate controlling parent is Home Warranty Holding Corporation, a Delaware corporation. The following abridged organizational chart depicts the Company's relative position within the holding company system as of December 31, 2006:



*As of January 1, 2007, Home Warranty of America, Inc., an Illinois corporation became 100% owned by Home Warranty Holding Corporation, the ultimate corporate parent.

The management of the Company is under the control of a single-member board of directors. The director and officers duly elected and serving as of December 31, 2006, are shown as follows:

Directors

Name and Residence

Principal Business Affiliation

Marc Roth
Buffalo Grove, Illinois

President and Chief Executive Officer
Home Warranty of America, Inc.

Principals Officers

Name

Title

Marc Roth
Robert Sobel

President and Chief Executive Officer
Secretary

Management Agreements

Service Agreement: On December 16, 2004, the Company entered into a service agreement with its parent, Home Warranty of America, Inc., an Illinois corporation (HWA). Under the terms of the agreement, HWA provides the Company with certain administrative support services including but not limited to the following: computer services and equipment; human resources; payroll; supplies; facility space; and back office support services. In 2005 and 2006, the Company incurred expenses in the amount of \$17,310 and \$146,740, respectively, for services rendered under this agreement. The service agreement was reviewed and approved by the California Department of Insurance during the application process.

Since the inception of the agreement, the Company has not reimbursed HWA for services rendered. HWA has not required the Company to settle the intercompany payable due, which includes amounts owed under the terms of the service agreement. The Company has experienced significant operating and net losses since it began operations and HWA has permitted the Company to accrue the amounts

owed under the terms of the agreement, without payment, to prevent the Company from depleting its operating cash or investment reserve accounts. In June 2007, the Company paid all outstanding payables to its parent and is no longer in arrears. The Company also indicated that it will continue to settle intercompany balances on a monthly basis.

Tax Allocation Agreement: The Company's federal income tax return is consolidated with that of its parent, Home Warranty of America, Inc., an Illinois corporation (HWA). Pursuant to a written agreement dated January 1, 2005, the amount of the Company's tax liability or refund is determined as if the Company was filing on a separate return basis. Under the terms of the agreement, estimated tax installments due the parent are payable within ten days of receiving notice of such payment.

A review of the Tax Allocation Agreement disclosed that it was not reported by the Company in its annual Holding Company (Form B) filings, which is a violation of California Insurance Code (CIC) Section 1215.4(b)(3)(H). In addition, the Company did not obtain prior approval for the agreement as required by CIC Section 1215.5(b)(4). Based on these findings, it is recommended that the Company submit this agreement to the California Department of Insurance for approval, and also report it on its annual Form B filings.

CORPORATE RECORDS

The Company's board actions regarding the authorization and approval of investments did not satisfy the requirements of California Insurance Code (CIC) Sections 1200 and 1201. The Company's minutes failed to document the authorization or approval of its investments, which is in violation of CIC Section 1200. In addition, specific references to amounts, facts and the values of the securities were not included as required under CIC Section 1201.

It is recommended that the Company implement procedures to ensure future compliance with CIC Sections 1200 and 1201.

TERRITORY AND PLAN OF OPERATION

The Company is licensed to sell home protection contracts only in California. The Company offers 13-month extended warranty protection programs and a 12-month contract program. The 13-month programs are offered to consumers who are involved with real estate transactions, and the 12-month program is offered directly to consumers who are not involved in real estate transactions. Policies primarily cover mechanical systems and home appliances. Optional coverages are also available covering other items such as air conditioning, roof leaks and repairs, pools, and spas.

The Company's sales focus is primarily in Southern California. Marketing of its home protection contracts is performed by the Company utilizing one sales manager, five sales representatives and third party real estate professionals.

In 2006, the Company's direct contract fees written increased by \$476,965 from \$28,906, prior year end, to \$505,871.

The Company is in the process of applying for licenses in the states Virginia and Florida.

LOSS EXPERIENCE

The Company reported operating and net losses in all years under examination as follows:

Year	Net Operating Loss	Net Loss
2005	\$ (66,155)	\$ (51,153)
2006	(402,951)	(360,846)
2007(*)	(48,353)	(39,410)
Totals	\$(517,459)	\$ (451,409)

(*) Through March 31, 2007

As reflected above, the Company has sustained operating and net losses in every year since its inception. In total, through March 31, 2007, the Company reported net operating losses and net losses of \$517,459 and \$451,409, respectively. The poor operating results are primarily the result of high overhead expenses coupled with insufficient premium income due to the general slowdown in the real estate market. The reported applications received totaled 1,394 in 2006, its first full year of operations, compared to 75 in 2005.

On March 28, 2007, as a result of the continued poor operating results reported in the December 31, 2006 Annual Statement, the California Department of Insurance requested that the Company provide a Plan of Action discussing what corrective actions have been taken or are planned. In response to this request, the Company indicated the following:

- (1) Management is continuously monitoring the Company's operating results and continues to feel that the high level of expenses is necessary to build the business.
- (2) As sales increase and the sales cost per contract decreases, the surplus of the Company will be favorably impacted.
- (3) The Company's parent infused \$500,000 of capital to the Company during June, 2007 and is able to infuse additional capital if needed.

The Company's strategic plan is to build for future growth and it believes that this is more important than expense reductions at the current time.

REINSURANCE

The Company has no reinsurance.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Underwriting and Investment Exhibit for the Year Ended December 31, 2006

Reconciliation of Surplus as Regards Contract Holders
from June 16, 2005 through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 438,608	\$	\$ 438,608	
Stocks:				
Common stocks	525,018		525,018	
Cash on hand and on deposit	112,190		112,190	
Home protection contract fees receivable	<u>44,244</u>	<u>8,000</u>	<u>36,244</u>	
Total assets	<u>\$ 1,120,060</u>	<u>\$ 8,000</u>	<u>\$ 1,112,060</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustment			\$ 3,000	(1)
Other expenses			7,413	
Taxes, licenses and fees			14,184	
Unearned home protection contract fees			219,767	
All other liabilities: payable to affiliates			<u>381,289</u>	(2)
Total liabilities			625,653	
Common capital stock		\$ 80,000		
Gross paid-in and contributed surplus		720,000		
Unassigned funds (surplus)		<u>(313,593)</u>		
Total surplus as regards contract holders			<u>486,407</u>	
Total liabilities, surplus and other funds			<u>\$ 1,112,060</u>	

Statement of Income, Capital and Surplus
for the Year Ended December 31, 2006

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 302,325
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Deductions:

Claims incurred	\$ 57,345	
Claims service expenses incurred	44,659	
Other expenses incurred	<u>603,272</u>	

Total deductions		<u>705,276</u>
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Net underwriting loss		(402,951)
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Investment Income

Net investment income earned	\$ 39,945	
Net realized capital gains	<u>2,160</u>	

Net investment gain		<u>42,105</u>
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Net loss		<u>\$ (360,846)</u>
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Capital and Surplus Account

Surplus as regards contract holders, December 31, 2005		\$ 755,780
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Net loss	\$ (360,846)	
Change in non-admitted assets	(6,700)	
Change in unrealized gain on investments	<u>98,173</u>	

Change in surplus as regards contract holders		<u>(269,373)</u>
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Surplus as regards contract holders, December 31, 2006		<u>\$ 486,407</u>
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Reconciliation of Surplus as Regards Contract Holders
from June 16, 2005 through December 31, 2006

Surplus as regards contract holders, June 16, 2005, per Examination			\$ 806,463
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net loss	\$	\$ 411,999	
Change in nonadmitted assets		8,000	
Change in unrealized gain in investments	<u>99,943</u>	<u> </u>	
Totals	<u>\$ 99,943</u>	<u>\$ 419,999</u>	
Net decrease in surplus as regards contract holders for the examination period			<u>(320,056)</u>
Surplus as regards contract holders, December 31, 2006, per Examination			<u>\$ 486,407</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Adjusted and Unpaid or in Process of Adjustment

Based on a review of claim payments and reserves subsequent to the examination date, the reserves for the above captioned account appear reasonable and have been accepted for purposes of this examination.

(2) All Other Liabilities: Payable to Affiliates

This account largely consists of amounts owed to the Company's parent, Home Warranty of America, Inc., an Illinois corporation (HWA), under the terms of the Company's service agreement with HWA. The Company has experienced significant operating and net losses since it began operations in September 2005. As a result, HWA has permitted the Company to accrue amounts owed under the terms of the service agreement to prevent the Company from depleting its operating cash.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control - Tax Allocation Agreement (Page 5): It is recommended that the Company submit this agreement to the California Department of Insurance for approval, and also report it in its annual Form B filings.

Corporate Records (Page 5): It is recommended that the Company implement procedures in its board meetings to ensure compliance with California Insurance Code Sections 1200 and 1201.

Previous Report of Examination

None.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/
Martha Young
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California